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In The

Supreme Court of the United States

October Term, 1996

QUALITY KING DISTRIBUTORS, INC.,

Petitioner,

v.

L'ANZA RESEARCH INTERNATIONAL, INC.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF OF AFTA, AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE[1]

The *amicus* on this brief are as follows:

The American Free Trade Association ("AFTA") is an incorporated trade association of independent American importers, distributors and wholesalers of parallel import fragrances, grooming products and cosmetics. Many of the Association's members are small businesses which are located throughout the United States and which employ hundreds of American citizens.

Parallel imports, sometimes also referred to as "gray market" goods, are genuine trademarked consumer products, such as fragrances, cosmetics, hair care products, body care products, cameras, electronic products and watches, which are typically manufactured abroad and imported by independent American importers rather than by "authorized" U.S. importers and distributors. Parallel imports exist because the manufacturers, for reasons of their own, seek significantly higher prices for their products in the United States than elsewhere in the world.

The *amicus* have a vital stake in the outcome of this case, and some of them have filed previous *amicus* briefs on similar issues.[2] The instant challenge is just one prong

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[1] Letters from all parties consenting to the filing of this brief have been filed with the Clerk of this Court. Counsel for a party did not author this brief in whole or in part. No person or entity, other than the Amicus Curiae, its members, or counsel made any monetary contribution to the preparation and submission of this brief.

[2] *K mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986); *Olympus Corp. v. United States*, 792 F.2d 315

of a full-scale attack by some manufacturers who are attempting to eliminate the legitimate and beneficial competition presented by the parallel importation and reimportation of their own products. This is a strategy that has been unsuccessful through the use of trademark and patent rights.

SUMMARY OF THE ARGUMENT

This case involves competing interpretations of the relationship between the first sale doctrine found in 17 U.S.C. § 109 and the import restriction found in 17 U.S.C. § 602. According to the Ninth Circuit below, absent permission of the U.S. copyright holder, the importation and subsequent distribution of foreign bought products bearing a U.S. copyright constitutes infringement, even when the copyright owner itself has already sold the same goods and earned a return on that sale. The Court concluded that the first sale doctrine does not apply to products imported into the United States. In other words, the copyright owner has a complete and absolute right to control importation of products bearing his or her copyright even if he has previously sold the copy of the product, without restriction, and made a profit from the sale.

By contrast, the Third Circuit in *Sebastian Intern. v. Consumer Contacts Ltd., infra,* held that the first sale by a

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(2d Cir. 1986), *cert. denied,* 486 U.S. 1042 (1988); *Bell and Howell: Mimiya Co. v. Masel Supply Co.,* 719 F.2d 42 (2d Cir. 1983), *cert. denied,* 479 U.S. 950 (1987); *Johnson & Johnson Products, Inc. v. DAL International Trading Co.,* 798 F.2d 100 (3d Cir. 1986); *Sebastian Intern. Inc. v. Consumer Contacts Ltd.,* 847 F.2d 1093 (3d Cir. 1988); *Cosmair, Inc. v. Dynamite Enterprises, Inc.,* 226 U.S.P.Q. 334 (S.D. Fla. 1985).

copyright holder extinguishes the copyright regardless of the place of sale. This alternate reading preserves the traditional balance between the copyright holder's right to earn a just return and the policy against unduly restricting free alienation of property.

The legislative history of the Copyright Act, in its various incarnations, shows that Congress was aware of the struggle by the copyright owner to restrict the application of the first sale doctrine and refused to legislate such a right. Moreover, the record reveals an acceptance of the legitimacy of the first sale abroad in extinguishing the rights of the copyright owner.

More broadly, the greater interests of the country are served by rejecting the interpretation rendered by the Ninth Circuit. The application of a design to the packaging of a non-copyrightable product, solely for the purpose of obtaining the monopolistic ability to manipulate prices in different markets and to restrain legitimate competition, constitutes an abuse of the original purpose of the copyright statute. Such a tipping of the scales defeats the traditional balancing of rights encompassed in our copyright laws.

ARGUMENT

I. THE NINTH CIRCUIT'S THEORY.

We come before the Court to resolve the Ninth Circuit's express and direct conflict with the Third Circuit's decision in *Sebastian International, Inc., v. Consumer Contacts, Ltd.,* 847 F.2d 1093 (3d Cir. 1988). The conflict arises from the differing interpretation of the relationship between 17 U.S.C. § 602(a) ("the import restriction") and 17 U.S.C. § 109(a) ("the first sale doctrine"). This difference in the interpretation of these sections has developed

from an inconsistent and often contradictory line of reasoning by the Ninth Circuit.[3]

The first sale doctrine as codified in 17 U.S.C. § 109 states in pertinent part as follows:

> § 109. Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord
> (a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

The import restriction as codified in 17 U.S.C. § 602 states in pertinent part as follows:

> § 602. Infringing importation of copies or phonorecords
> (a) Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501.

These provisions were first reconciled by the Third Circuit in *Sebastian Int'l, Inc. v. Consumer Contacts Ltd.*, 847 F.2d 1093 (1988). Sebastian International, Inc., a California Corporation, marketed and manufactured hair products which displayed on their packaging a registered copyright. Sebastian retained a South African company to act

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[3] *Compare, BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991), *cert. denied*, 505 U.S. 1206 (1992); *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994), *cert. denied*, 131 L.Ed.2d 197 (1995); *Denbicare U.S.A., Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996); *Lanza Research International, Inc. v. Quality King Distributors, Inc.*, 98 F.3d 1109 (9th Cir. 1996).

as sole distributor for the South African market. *Sebastian Int'l, Inc. v. Consumer Contacts Ltd.*, 664 F.Supp. 909 (D.N.J. 1987), *vacated*, 847 F.2d 1093 (3d Cir. 1988). Instead of selling the product exclusively in South Africa, the distributor sold some of the merchandise back into the United States. Sebastian brought suit claiming the reimportation violated § 602. The District Court accepted Sebastian's arguments and granted a preliminary injunction.

On appeal the Third Circuit reversed and remanded the decision. *Sebastian Int'l, Inc. v. Consumer Contacts Ltd.*, 847 F.2d 1093 (1988). The Court ruled that § 109(a) and § 602(a) were interdependent and may be read in harmony. The Court focused on the fact that the copyright holder had manufactured and sold the product thereby gaining his just reward in its sale. Furthermore, the Court rejected the claim that the place of the sale was controlling. In doing so, the Court noted, "we do not confront a license agreement or copies produced in a foreign country under that agreement by someone other than the owner" and thus concluded "clearly the copyright owner already has received its reward through the purchase price" *id.* at 1098-99.

The Ninth Circuit first addressed these sections in *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991), *cert. denied*, 505 U.S. 1206 (1992). In that case, the defendants purchased phonorecords manufactured abroad and imported them into the United States. The U.S. owner of the sound recordings contained on the phonorecords sued under section 602(a). The defendants argued that the first sale doctrine extinguished the copyright holder's rights to the phonorecords. The Ninth Circuit held that the first sale doctrine as codified in section 109(a) was

limited by the phrase "lawfully made under this title" which the Court held meant "legally manufactured and sold within the United States." *BMG Music*, 952 F.2d at 319.[4]

Despite the criticism of legal commentators against the theory set forth in *BMG*, the Ninth Circuit again partially relied on the "lawfully made under this title" argument in *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994), *cert. denied*, 131 L.Ed.2d 197 (1995). The Court tried to buttress its argument by stating that to rule otherwise would render § 602(a) meaningless.

The Ninth Circuit distanced itself from the earlier theories and broadened its interpretation of § 602(a) in the instant decision. In *Lanza Research International, Inc. v. Quality King Distributors, Inc.*, 98 F.3d 1109 (9th Cir. 1996), the Ninth Circuit abandoned the reasoning in *BMG* that the first sale applied only to goods made geographically in the United States. Instead, the Court concluded that § 602(a) superceded § 109(a) because, to hold otherwise would defeat congressional intent and render § 602(a) meaningless. In entering this ruling, the Ninth Circuit expressed direct conflict with the ruling in *Sebastian*. In an effort to justify this approach the Ninth Circuit ignored its earlier ruling in *Denbicare U.S.A., Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996), and delved into the adequacy of the reward received by the copyright owner. The Ninth Circuit was wrong in its ruling and in its interpretation of the relevant statutes.

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[4] Section 106 provides that "the owner of copyright under this title" has the exclusive right to reproduce, or to authorize the reproduction, of a copyrighted work. Thus, we agree with Petitioner that "lawfully made under this title" must refer to reproductions made or authorized by the U.S. copyright holder, regardless of where they are manufactured.

II. THE IMPORT RESTRICTION IS NOT APPLICABLE WHERE THE U.S. COPYRIGHT HOLDER HAS EITHER EXERCISED OR AUTHORIZED THE DISTRIBUTION OF THE COPY.

A. The Plain Meaning

It is appropriate to look to the "plain meaning" of a statute in reaching a plausible interpretation of its intended purpose. *United States v. National Bank of Commerce*, 472 U.S. 713 (1985); *United States v. American Trucking Association, Inc.*, 310 U.S. 534, 542 (1940). We believe that the "plain meaning" of § 602 is that in situations such as the instant matter where the copyright holder received its "reward" on its sale of the merchandise, the first sale doctrine codified in § 109(a) *exhausts* the distribution right found in § 602.

In this regard, it is important to understand that in assessing whether the statutory language has a "plain meaning" it is necessary to look at more than just the words themselves. One must consider these words within the structure, logic and purpose of the entire statute of which the relevant language is a part. "We look not only to the relevant language, but to the design of the statute as a whole and to its object and policy." *Spencer v. Brown*, 17 F.3d 368, 372 (Fed. Cir. 1994).

As this Court itself has observed, the function of courts interpreting statutes "is to construe the language so as to give effect to the intent of Congress." *American Trucking Association, Inc.*, 310 U.S. 534, 542 (1940). A very important guide to that intent is an act's "general purpose."

> [C]ourts will construe the details in an act in conformity with its dominating general purpose, will read the text in the light of context and will interpret the text so far as the meaning

> of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350-51 (1943). For this purpose, the Copyright Act "must be read as a whole." *Desylva v. Ballentine*, 351 U.S. 570, 573 (1956).

This Court has long held that the fundamental purpose of the Copyright laws presses in favor of encouraging unrestricted trade in copies released to the market by the copyright holder.

> The limited scope of the copyright holder's statutory monopoly, like the limited copyright duration required by the constitution, reflects a balance of competing claims upon the public interest: Creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts. The immediate effect of our copyright law is to secure a fair return for an "author's" creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good. (Footnotes ommitted)

Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975), *quoting Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932); *see also Fogerty v. Fantasy, Inc.*, 510 U.S. 517 (1994).

> The primary objective of copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.' To this end, copyright assures authors the right to their original expression, but encourages others to build freely upon the ideas and information conveyed by a work. (Citations omitted.)

Id., quoting Feist Publications, Inc. v. Rural Telephone Service Co., 499 U.S. 340, 349-350 (1991).

Given that the purpose of the law is not to reward the author, but to give the public maximum access to creative

work, "[t]he financial reward guaranteed to the copyright holder is but an incident of this general objective, rather than an end in itself." *Berlin v. E.C. Publications, Inc.*, 329 F.2d 541, 543-544 (2d Cir. 1964). Based on this reasoning, the Third Circuit correctly found that "[u]ltimately, the Copyright law regards financial reward to the owner as a secondary consideration." *Sebastian*, 847 F.2d at 1095.

In this context, the plain meaning of the related statutory provisions is clearly discernible. Section 106 provides that the owner of the copyright has "right to do or authorize" certain acts, including the right "to distribute . . . or transfer ownership". 17 U.S.C. § 106(3). Once that right has been exercised and the "reward" received, § 109(a) terminates any further rights under § 106(3). The importation provisions in § 602 do not create any new or additional substantive rights beyond those provided for in § 106, rather they merely indicate that unauthorized importation would be a violation of the "exclusive right to distribute." Where the U.S. copyright holder has authorized or exercised that right, and received its reward, any further rights under § 106(3) are terminated. Consequently, "the right does not survive so as to be infringed by importation." *Sebastian*, 847 F.2d at 1099. Thus, on the face of these provisions § 602 applies only to those situations where the U.S. copyright holder has neither exercised or authorized the right of distribution, *i.e.*, piratical copies or initial sales by third parties who are not authorized by or related to the U.S. Copyright holder. *See c.f. K mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988).

This reading of the relevant statutory language comports with the purpose, logic and structure of the statute as a whole. It allows each of the three provisions at issue

to be given substantive force and effect without obliterating the rights and obligations created by the related provisions. Moreover, as shall be demonstrated below, this reading comports with the legislative intent reflected in both the 1976 and 1990 amendments to the statute.

B. The 1976 Amendments To The Copyright Statute

The Ninth Circuit's interpretation of legislative history is partially founded on the belief that the legislative history of the 1976 Copyright Act contains no explicit reference to the interaction between §§ 602(a) and 109(a). *Lanza*, 98 F.3d at 1115. Starting from such an assumption, the Court looked to "the scenarios that were discussed by representatives of the printing and recording industries in assessing § 602(a)[.]" *Id.*, at 1116. This assumption is at least partially incorrect.[5]

Although §§ 602(a) and 109(a) were not explicitly contrasted in the legislative history, the question of the interrelation of the first sale doctrine and the import restriction was addressed on several occasions during the

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[5] Confusion as to the meaning of the 1976 Act and its legislative history is not completely unwarranted. The act is complicated and often unclear. Little, if any, substantive discussion took place amongst the members of Congress that passed the Act. Instead, most of the statutory language is based on the suggestions of industry representatives with economic interests in the outcome of the act. As at least one commentator has noted: "In some cases, affected parties agreed upon language, which was then adopted by Congress, while disagreeing about what the language meant." Copyright, Compromise and Legislative History, 72 Cornell L. Rev. 857 (1987). Whether the legislature's ultimate intent in any way relates to the intent of the various interest groups is at best calculated speculation.

early years of committee discussions on the 1976 Copyright Act. The 1961 tentative draft of the bills that were to become the 1976 Act preserved the import restriction against counterfeit goods which had existed under the prior law, but did not include an import restriction for genuine products. However, pressure was building from publishing interests to expand the definition of counterfeit goods or to otherwise ban the importation of copyrighted works in violation of private geographical restrictions. The Registrar of Copyrights in his 1961 report to Congress recognized these pressures and noted its opposition to imposing any such restrictions upon innocent buyers:

> When arrangements are made for both a U.S. edition and a foreign edition of the same work, the publishers frequently agree to divide the international markets. The foreign publisher agrees not to sell his edition in the United States, and the U.S. publisher agrees not to sell his edition in certain foreign countries. It has been suggested that the import ban on piratical copies should be extended to bar the importation of the foreign edition in contravention of such an agreement. Some countries, including the United Kingdom, bar importation in this situation, apparently on the ground that, even though the copies were authorized, their sale in violation of a territorial limitation would be an infringement of the copyright. In the United States, there is no clear decision as to whether the sale of authorized copies beyond a territorial limitation is an infringement. But the import ban on "piratical copies" does not seem to apply to authorized copies. We assume, without considering the antitrust questions involved, that agreements to divide international markets for copyrighted works are valid and enforcible [sic]

> contracts as between the parties. **But we do not believe that the prohibition against imports of piratical copies should be extended to authorized copies covered by an agreement of this sort. To do so would impose the territorial restriction in a private contract upon third persons with no knowledge of the agreement.** And even as between the parties, Customs does not seem to be an appropriate agency for the enforcement of private contracts.

Report of the Registrar of Copyrights on the General Revision of the U.S. Copyright Law, at 125-126 (July 1961), *reprinted in* 3 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (George S. Grossman ed., 1977) (emphasis added)

Clearly, even at this very early date in the consideration, the hypothetical focuses on a situation where the copyright owner in the United States has not earned a reward for the sale of the product and the first sale went to an independent foreign interest. This idea would continue to underly future consideration.

In the 1963 draft this idea took form when the prototype of modern § 602(a) was added to the proposed copyright revision. Two versions of this section were debated. In one version, Customs would enforce the restriction. In the other version, the restriction would only create a cause of action, but would not be enforced by Customs. At the insistence of the Department of the Treasury and of the Customs Service the latter version prevailed. The language in this early version of the section stated:

> (a) Importation into the United States of copies or records of a work for the purpose of distribution to the public shall, if such articles are imported without the authority of the owner of the exclusive right to distribute copies or

> records under this title, constitute an infringement of copyright actionable under section 35.

Preliminary Draft for Revised U.S. Copyright Law (1963) *reprinted in* 5 THE KAMINSTEIN LEGISLATIVE HISTORY PROJECT: A COMPENDIUM AND ANALYTICAL INDEX OF MATERIALS LEADING TO THE COPYRIGHT ACT OF 1976, at 420-421 (Alan Latman & James F. Lightstone eds., 1984)

Substantial comment led to this early draft. Most of these comments focused on situations where a foreign copyright owner sold genuine goods directly or indirectly into the United States. *Panel Discussions and Comments on 1961 Report (Part 2)* (2/15/63 issued), at 213 (March 15, 1962), *reprinted in* 3 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (George S. Grossman ed., 1977) (Comment of Sidney A. Diamond, London Records regarding sale by foreign publisher to third party who then shipped to U.S.); *Id.* at 226 (Comment of American Book Publishers Council, Inc., and American Textbook Publishers Institute). Alternatively the comments dealt with the legitimate product which, by some means, reaches illicit hands and is subsequently sold in the U.S. *Id.* at 213 (Comment of Edward A. Sargoy, Committee on Program Revision (film prints)). These comments share in common situations in which the U.S. copyright owner has not earned compensation for the first sale of the work. Nowhere do they mention the first sale doctrine.

The first sale doctrine does not enter the discussions between the various industry participants until January 15, 1964. In these discussions, before the arrayed representatives of the committee, it was clearly stated that whether a particular shipment violates the new import restriction depends on whether a valid first sale has taken place:

> Irwin KARP (Authors League of America):
> . . . there is a section now somewhat similar to

old section 27 which distinguishes between copyright and property in the object and which says " . . . but nothing in this title shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained." If a German jobber lawfully buys copies from a German publisher, are we not running into problems of restricting his transfer of his lawfully obtained copies?

Abe A. GOLDMAN (Copyright Office): I would suppose that the whole answer depends on whether the distribution that would take place in the United States would itself constitute an infringement of copyright. **When you apply this rule about the effect of the first sale of a copy exhausting the right to control further the distribution of that copy, your question would be whether this represents a sale of the copy that does exhaust the right.**

KARP: You are right Abe.

GOLDMAN: **This would vary from one situation to another, I guess.**

* * *

KARP: I am saying that the very first sale here is a perfectly legitimate and legal sale, and that brings into play the very basic concept of copyright law that, once you've sold a copy legally, you can't restrict its resale.

Julian T. ABELES (Music Publishers' Protective Association, Inc.): Well, everybody down the line is selling without authority, regardless of whether it is imported or not. If he sells it, he is liable.

Transcript of Meeting on Preliminary Draft for Revised U.S. Copyright Law: Discussions of §§ 45-53, at 211-212 (January

15, 1964) *reprinted in* 3 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (George S. Grossman ed., 1977) (emphasis added)

No one spoke up to challenge this reasoning or to state that no first sale abroad would be valid. Although not conclusive of the intent of the legislators who eventually passed the act, it certainly shows the failure of the committee, when presented with the opportunity, to express an intent to supplant the first sale doctrine.

The last major change in the language of the statute, for purposes of this discussion, was issued in 1966 and states:

> Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work ~~for the purpose of distribution to the public~~ *that have been acquired abroad* is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501. This subsection does not apply to [importation by an organization operated for scholarly, educational, or religious purposes and not for private gain, with respect to copies or phonorecords intended to form a part of its library.]

H.R. 4347, 98th Congress, 2d Sess. (1966) *reprinted in* 5 THE KAMINSTEIN LEGISLATIVE HISTORY PROJECT: A COMPENDIUM AND ANALYTICAL INDEX OF MATERIALS LEADING TO THE COPYRIGHT ACT OF 1976, at 432-433 (Alan Latman & James F. Lightstone eds., 1984) At first glance this language might seem to buttress the Ninth Circuit's theory. A further look at the legislative record brings such a reading into question.

In the Hearings before Subcommittee No. 3 of the Committee on the Judiciary (House), the very hearings

which preceded this change, Representative Robert Kastenmeier accepted a statement by Robert T. Jordan, of the staff of the Council on Library Resources, to be read into the record. The statement unambiguously states in its pertinent part:

> Section 602 (p. 33, lines 21-25) *Infringing importation:* **Once a copyright article is lawfully purchased, there should be no geographical restriction on where the purchaser can resell.** In fact, section 109 specifies that "the owner of a particular copy or phonorecord * * * is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."

Hearings on H.R. 4347, H.R. 5680, H.R. 6831 and H.R. 6835, before Subcommittee No. 3 of the Committee on the Judiciary (House), 89th Congress, 1st Sess., at 468 (1965) (p. 468) *reprinted in* 5 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (George S. Grossman ed., 1977)

Again, after this statement was made a part of the record, no voice rang out challenging the accuracy of the conclusion. Despite various questions regarding other statements by speakers, no one reading this statement thought to comment on its accuracy.

It is important to remember that the amendments in 1976 also recodified the "first sale" doctrine. In describing the scope of § 109, the Senate Judiciary Committee used the following language:

> § 109(a) restates and confirms the principal that where **the copyright owner has transferred ownership of a particular copy** or phonorecord of his work, the person to whom the copy or phonorecord is transferred is entitled to dispose of it by sale, rental, or any other means.

S. Rep. No. 983, 93d Cong., 2d Sess. 131, at 128 (1974), *reprinted in* 13 OMNIBUS COPYRIGHT REVISION LEGISLATIVE HISTORY (George S. Grossman ed., 1977) (emphasis added).

In short, Congress reaffirmed the long held position that where the copyright holder had received its reward or compensation, further restraints on the alienation of the property were simply not justified.

In summation, the legislative history to the 1976 amendments reflects that the "problem" which was brought to the attention of the Congress involved the situation where the U.S. copyright holder had not earned compensation for the copy of the work for which the import restriction was sought. It must be presumed that it was this problem that Congress sought to remedy. At the same time, Congress, by not limiting § 109 in its text, clearly confirmed that where the U.S. copyright holder had received its compensation, further restrictions were not justified. *See also* S. Rep. No. 983, 93d Cong., 2d Sess. 131, at 128, *supra*. These considerations support the plain meaning of the statutory language outlined above.

C. The 1990 Amendments To The Copyright Statute

The background to the changes made to the copyright laws in 1990 further support the plain reading of the statutory language outlined above. These changes arose as a response to a judicial decision interpreting the copyright holder's performance and distribution rights.

In *Red Baron Franklin Park v. Taito Corp.*, 9 U.S.P.Q. 2d 1901 (E.D. Va. 1988), *rev'd on other grounds*, 883 F.2d 275 (4th Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990), the defendant engaged in the purchase overseas, of a foreign made and copyrighted good, initially sold by the foreign copyright holder which was related to the U.S. copyright

holder. The District Court refused to grant an injunction against the importer, finding that the "first-sale" by the related copyright holder under § 109 overrode the import restriction in § 602. *Id.* The Circuit Court overturned this decision, not based upon the import restriction, but instead based on the fact that the public use of the copyrighted material violated the U.S. copyright holder's "performance right." *Red Baron Franklin Park v. Taito Corp.*, 883 F.2d 275, at 281 (1989).

In 1990, Congress specifically amended the copyright statute to overturn the effect of the ruling in *Red Baron*. *See* Judicial Improvements Act, Pub. L. No. 101-650 § 103 *reprinted in* 1990 U.S.C.C.A.N. 6935. Although Congress created certain exceptions to the "first-sale" doctrine, it did not choose to modify either § 109 or § 602 to clearly prohibit the applicability of the first sale abroad thereby overturning the interpretation employed by the *Red Baron* District Court. This creates a presumption that Congress accepted the conclusions of the District Court[6] that § 602 does not supersede the first sale doctrine, which should now enjoy the force and effect of law. *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982); *Wehrly v. United States*, 808 F.2d 1311 (9th Cir. 1986).

The Ninth Circuit below rejected this argument on the basis that, "in amending § 109(e) [first sale doctrine], Congress was concerned about the relationship between the first sale doctrine and § 106(4), not the relationship between the first sale doctrine and § 602(a)." This argument, that Congress overlooked the significance of the

[6] And the 1988 decision of the Third Circuit in *Sebastian International* upon which the District Court decision in *Red Baron* was based.

lower Court's ruling in amending the law, does not conform with the maxims of statutory interpretation and ignores the very legislative history of the act. As a general rule, Congress is deemed to know existing case law to which it is addressing legislation since "[w]e may fairly presume that Congress is aware of the common-law background against which it legislates[.]" *Chappell v. Robbins*, 73 F.3d 918 (9th Cir. 1996); *see also, Nordgren v. Burlington N. R.R.*, 101 F.3d 1246 (8th Cir. Minn. 1996) *reh'g, en banc, denied, Nordgren v. Burlington N. R.R.*, 1997 U.S.App. LEXIS 800 (8th Cir. Jan. 16, 1997); *Roche Prods. v. Bolar Pharm. Co.*, 733 F.2d 858 (Fed.Cir. 1984); *Webster v. City of Houston*, 689 F.2d 1220 (5th Cir. 1983).

In this instance, we know that Congress was aware of the common law background because it specifically detailed the case in its legislative history:

> The Committee has also been made aware of an anomaly in existing copyright law that prevents certain coin-operated equipment from being used for their intended purpose. In *Red-[sic] Baron Franklin Park, Inc. v. Taito Corp.*, a Japanese manufacturer of electronic audiovisual games **conceded that the first sale provisions of section 109(a) of the Copyright Act permitted a U.S. arcade game operator to purchase, in Japan, a circuit board containing the game and to then import the circuit board for insertion into a coin-operated arcade game in the United States.** The manufacturer, though, argued – and the court of appeals agreed – that the first sale doctrine does not act as a limitation on the public performance right. The court acknowledged that the circuit boards "have utility only in the hands of someone who plans to exploit them commercially." Nevertheless, the court

> held that the plain words of the statute dictated a finding of infringement.
>
> In order to rectify the anomaly in the Copyright Act that permits copyright owners of electronic audiovisual games designed for use in coin-operated equipment to sell printed circuit boards containing the games and then turn around and successfully sue to prevent use of the circuit boards for their intended purpose, the bill provides that the public performance right will not apply in the following very limited circumstances: where, in the case of electronic audiovisual games intended for use in coin-operated equipment, a lawfully made copy of such game has been purchased and is used in such equipment.

Judicial Improvements Act, Pub. L. No. 101-650 § 103, *reprinted in* 1990 U.S.C.C.A.N. 6935, 6947 (emphasis added).

Here, more than anywhere else in the legislative history of the Copyright Act, the legislature's intent to preserve the first sale doctrine for foreign sales in which the U.S. copyright owner has received compensation becomes clear and unambiguous. The legislature by its very words knew that the circuit boards in *Red Baron* had been purchased abroad and the purchase consituted a valid first sale. It knew that the boards had been imported into the United States. When it amended the Copyright statute to alter the performance right to "rectify the anomaly" that the goods could be purchased, but not used, it was evident that **the first sale doctrine must apply to foreign sales, otherwise Congress was doing a useless act.** If the foreign purchased circuit boards could not be imported pursuant to § 602(a), then the amendment to the performance right would have had no practical effect in the case of *Red Baron*. The boards would still

not have been usable in the United States. We must not presume that Congress did a useless thing or that it would rely on an inapplicable example as the basis for its statutory amendment. *See Nobel v. TVA*, 892 F.2d 1013 (Fed.Cir. 1989); 2B *Norman J. Singer, Sutherland Statutory Construction* § 49.11, at 83 (5th ed. 1992).

Thus the actions of Congress in 1990 should be read as affirming the lower court opinion in *Red Baron* and the holding of the Third Circuit in *Sebastian*. In view of the evident congressional intent the observation of the Third Circuit in 1988 is specially pertinent:

> This twist has created the anomalous situation in which the dispute at hand superficially targets a product's label, but in reality rages over the product itself. We think that **the controversy over "gray market" goods, or "parallel importing," should be resolved directly on its merits by Congress, not by judicial extension of the Copyright Act's limited monopoly.**
>
> *Sebastian*, 847 F.2d at 1099. (emphasis added)

D. The Adequacy Of Consideration Is Not A Proper Area For Judicial Scrutiny.

Based on the foregoing examination of the applicable legislative history, it is clearly apparent that a pronounced desire to preserve the geographically unlimited application of the first sale doctrine permeated the various perambulations of the Copyright Act. While the import restriction in § 602 was certainly designed to provide at least some greater protection for the copyright holder, nothing on the face of the statute suggests that it is intended to allow a copyright holder to restrain trade, after he has received a "reward" for his copyright. When a copyright holder directly or through a related company

sells a work overseas, he is receiving his fair "reward" regardless of the price which he charges. The mere importation of a work by the purchaser does not mean that the copyright holder did not receive a "reward" for his copyright. *Cosmair, Inc. v. Dynamite Enterprises, Inc.*, 226 U.S.P.Q. 344 (S.D. Fla. 1985); *Red Baron Franklin Park v. Taito Corp.*, 9 U.S.P.Q. 2d 1901 (E.D. Va. 1988); *Red Baron Franklin Park v. Taito Corp.*, 883 F.2d 175 (4th Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990); *Sebastian International*, 847 F.2d at 1099.

The Ninth Circuit's incursion into the sufficiency of the price asked by the copyright owner for its sale was unwise and unwarranted. It is a basic maxim of contract law that "the adequacy of consideration is not a proper subject for judicial scrutiny." E. Allan Farnsworth, FARNSWORTH ON CONTRACTS, 99 (1990). The Ninth Circuit itself affirmed this general principle with regards to copyright sales in *Denbicare U.S.A. Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996) where it held that when a copyright owner consents to the sale of a product bearing his or her copyright it constitutes a valid first sale regardless of the value received by the copyright owner. The Ninth Circuit's new ruling in this case by overturning *Denbicare* and challenging whether the consideration justified the exchange, opens a Pandora's box for factual inquiries in millions of copyright transactions. These inquiries are not warranted by the Copyright statute nor by general precepts of contract law.

III. THE FAIR USE DOCTRINE PROVIDES FURTHER SUPPORT FOR THE REVERSAL OF THE DECISION BELOW.

Further limitations on the exclusive rights of the Copyright holder, provided for in § 106, are found in

§ 107, the fair use doctrine. As will be discussed in detail below, this doctrine provides an independent basis for permitting the import and sale of the products at issue. Initially, however, it must be observed that this provision deals with the uncompensated use of copyrighted material. Thus, the mere existence of this doctrine reflects that the primary intent of Congress is to provide maximum public access to the creative work and strongly supports the above analysis that once the copyright holder has received compensation, further restrictions on the distribution of the copy are not justified.

The fair use doctrine, codified in 17 U.S.C. § 107, sets forth a general, equitable exception to the rights of the owner of the copyright in a work, subject to the discretion of the Court. *Pacific and Southern Co., Inc. v. Duncan*, 744 F.2d 1490 (11th Cir.), *reh'g denied*, 749 F.2d 733 (11th Cir.), *cert. denied*, 471 U.S. 1004 (1984). This provision is in essence "an equitable rule of reason" and wisely allows courts flexibility in accounting for ever changing situations in a technologically complex world. *Harper & Row, Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539 (1985). That statute sets forth in relevant part:

> Notwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include –
>
> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;

(2) the nature of the copyrighted work;

(3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and

(4) the effect of the use upon the potential market for or value of the copyrighted work.

17 U.S.C. § 107[7]

In the instant case, the Court is faced with the misuse of a copyright to restrain legal trade in non-creative products. When a consumer buys a book, her intent is to purchase the copyrighted work on the page. When a consumer buys a compact disk, his intent is to purchase the copyrighted music etched on its reflective surface. When a consumer buys a computer game cartridge, her goal is to purchase the game encoded within. However, when a consumer purchases a shampoo, electronic equipment or a fragrance, which displays a copyrighted design on its packaging, he or she is really buying the underlying product.

In such circumstances the object of the purchase, and the far greater portion of the product, is purely functional. However, by affixing a non-removable copyrighted label or design to the package, the manufacturer tries to imbue with all the benefits of the copyright

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[7] Although the statute suggests that it may be applied "for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research" it does not limit its application to such examples. "The text employs the terms 'including' and 'such as' in the preamble paragraph to indicate the 'illustrative and limitative' function of the examples given, which thus provides only general guidance about the sorts of copying that courts and Congress will most commonly have found to be fair uses." *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 577 (1994).

monopoly, the underlying functional product. Such use of the copyright laws was not intended by Congress.

Admittedly, a review of the literature of prior decisions concerning the application of § 107 has revealed no case in which the Fair Use doctrine has been applied to copyright designs on commercial labels or packages. However, when dealing with the question of copyrighted labels, courts have had to face the risk of the "tail wagging the dog" by allowing proprietors to "leverage their thin copyright protection over the label into a monopoly on the typical uncopyrightable product to which it is attached." 1 NIMMER ON COPYRIGHT § 2.08[G][2], at 2-138 (December 1996). By stepping through the considerations suggested by § 107, the propriety and necessity of avoiding such a result in this instance becomes apparent.

A. The purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes.

Traditionally, the Court looks more kindly on nonprofit educational uses in applying this test. *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S., 417 (1984). However, the reason for this is not the mere fact that the user makes a profit "but whether the user stands to profit from exploitation of the copyrighted material without paying the customary price." *Harper & Row*, 471 U.S. at 562; *See also, Roy Export Co. Establishment v. Columbia Broadcasting System, Inc.*, 503 F.Supp. 1137, 1144 (S.D.N.Y. 1980); 3 NIMMER ON COPYRIGHT § 13.05[A][1], at 13-71, n. 25.3 (1996). In other words, as we repeatedly argued above, the question for the Court should be whether the copyright owner received his reward for the sale of the product.

Admittedly, the importer or reseller who purchases the product abroad and tries to import it into the United

States is doing so for a commercial purpose. However, the significant distinctions from the traditional model are that in the instant case the copyright holder has received his reward and that the importer brings the product into the United States not to traffic in the copyright, but instead in the underlying product. This business, often referred to as parallel market or derisively as "gray market", has been previously examined by this Court and found to be a legitimate form of competition. *K mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988).

Although copying for a commercial purpose weighs against fair, use *Harper & Row, Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539, 560 (1985), no similar prejudice should attach to the legitimate resale of principally functional, genuine products. Particularly since, by placing the copyright on the product, the manufacturer has given the reseller no alternative but to sell the product bearing the copyright. If the reseller were try to obliterate the copyright design, she would invite a lawsuit for selling a defaced product. If the reseller were to try to rebottle or repackage the product, it could be financially prohibitive and thereby present an unfair impediment to legitimate trade. Where the manufacturer has chosen to place its copyrighted design on the product in a manner that cannot be legally removed, it should not later be able to claim copyright infringement in order to restrain trade. *See c.f. Sebastian International, Inc. v. Longs Drug Stores Corporation*, 53 F.3d 1073 (9th Cir. 1995) (manufacturer affixed collective mark to product to restrain trade).

B. The nature of the copyrighted work.

Not all copyrighted works are entitled to the same level of protection. *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F.2d 1510 (9th Cir. 1992). The nature of the copyrighted work in the instant case, is a label or a design

affixed to a package or container. Courts have tended to require a slightly higher degree of originality for copyrights related to labels or advertisements. Melville B. Nimmer, NIMMER ON COPYRIGHT, Vol. 1 § 2.08[G][2], December 1996. If the copyright on a label is viewed as a part of the total product, the portion of the value of the product that is affected by the copyrighted work is very small. In such a situation, the copyright should be given weak protection. *See e.g., Sega* at 1527.

C. The amount and substantiality of the portion used in relation to the copyrighted work as a whole.

Traditionally, when applied to literary or graphic works, the Court under this test makes a comparison between the total copyrighted work and the portion actually used by the party claiming "fair use." A small excerpt extracted from a book might be judged fair use because of its minor use in relation to the complete work. In the instant case, we need to consider the copyright in relation to the total product being sold. Such use is justified since, absent some method for removing the copyright, it is "necessary" to leave the entire copyrighted material on the product in order to sell the underlying functional product. *See, Twin Peaks Productions, Inc. v. Publications Intern., Ltd.*, 996 F.2d 1366 (2nd Cir. 1993); *Rubin v. Brooks/Cole Pub. Co.*, 836 F.Supp. 909 (D.Mass. 1993). In the novel situation presented in the instant case, we submit that the test should be applied as "the amount and substantiality of the portion copyright used in relation to the product as a whole."

Generally speaking, in relation to the functional product to which the copyright is affixed in a situation such as the one herein, the copyright is a very minor

portion of the total product – usually encompassing just a few lines or a small drawing on the surface of the package or container. Although the copyright design, it may be argued, contributes to the appearance and salability of the product, **this Court should reject the "sweat of the brow" rationale for copyright protection.** *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340 (1991). By indelibly combining his copyright with the underlying functional product, the copyright owner has rendered his work, on the whole, mainly functional. In such instances, the equitable considerations weigh on the side of free trade and public access.

D. The effect of the use upon the potential market for or value of the copyrighted work.

The effect of the use upon the market has been seen by Courts as one of the most important factors in determining the existance of fair use. *See, National Rifle Ass'n of America v. Handgun Control Federation of Ohio*, 15 F.3d 559 (6th Cir.), *cert. denied*, 130 L.Ed.2d 26 (1994). This case introduces unique elements to the application of this test. Unlike cases where portions of works or entire works are reproduced in a particular market without the copyright owner's consent, in the instant case, by altering its sale prices and foreign shipments the copyright owner has the complete control over what is sold. The copyright owner is being paid for the goods and the genuine, unaltered goods are merely being resold.

In addition to the foregoing factors, the Court should consider the public benefit resulting from this particular application of the fair use doctrine. The parallel market has existed and grown in the United States for a great many years. *See, K mart*. It is both a significant entity in its own right, as well as an important source of affordable

quality merchandise for U.S. consumers. Over the course of the last 50 years, a careful balance has been created to protect the legitimate interests of intellectual property right holders to receive compensation for their efforts without encouraging obstacles to free trade competition. To allow copyright owners to exploit § 602 to engage in discriminatory price manipulation in different national markets defeats efforts at free competition and trade.

The impact on our own economy of such unwarranted restrictions would be substantial. The parallel market represents a significant portion of the U.S. economy, involving practically the entire range of consumer products. In terms of fragrances which are closely related in sales and market to the products which are the subject of the instant litigation, industry lobbying organizations estimate that 25% of the market consists of parallel merchandise. *Unable to Protect Product Trademarks, Manufacturers Copyright the Boxes*, NEW YORK TIMES, November 24, 1994. In total, the parallel market constitutes a multi-billion dollar industry nationwide. *Circuit Prohibits Import of Gray-Market Goods*, THE NATIONAL LAW JOURNAL, January 27, 1997. Hair care products, however, are only a small portion of a large industry which includes cosmetics, household goods, games and home electronics. In short, we doubt that Respondent will dispute the economic significance of the industry at issue.

Based on the foregoing we believe that this Court would be justified in finding that, in limited circumstances where copyrighted designs are affixed to the package or container of a primarily functional product, the resale of that product constitutes a valid fair use of the copyright regardless of the location of the sale.

CONCLUSION

For the foregoing reasons, this Court should grant the petition and reverse the decision of the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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